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PASS USAID FOR CLAIMS -- WFULLER
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E.O. 12958: N/A
TAGS: EFIN ECON EAID XM XA XH XB XF FR
SUBJECT: PARIS CLUB - JULY 2009 MEETING

¶1. (SBU) Summary: During the July Paris Club meeting, creditors agreed to voluntarily go beyond the terms of the Heavily Indebted Poor Countries (HIPC) Initiative to forgive 100 percent of their claims pertaining to Haiti, which reached completion point under the Initiative on June 30. The Club agreed to send a letter to Brazil expressing disappointment over an imminent $700 million loan related to sale of Embraer aircraft to Aerolineas Argentinas/Austral, and its potential to undermine the Club's efforts to collect from Argentina. The Argentine central bank has reportedly benefitted from a $1.8 billion swap line from Brazil and a $10 billion swap line from China.

¶2. (SBU) The International Monetary Fund (IMF) representative reported that China had agreed to drop the sovereign guarantee requirement for the mining project in the Democratic Republic of Congo (DRC), leaving concessionality of the loan for one infrastructure segment as the only remaining issue. The IMF could seek financing assurances for a program under the IMF's Poverty Reduction Growth Facility (PRGF) in September or earlier. DRC could reach HIPC completion point with six months of PRGF performance. The Central African Republic (CAR) will be invited to negotiate HIPC completion point treatment in September. Paris Club creditors showed no interest in Angolan parliamentarians' proposal to swap its $400 million January 2010 payment for development, infrastructure, or investment.

¶3. (SBU) The Club also discussed Bahrain, Jamaica, Kazakhstan, Mali, Seychelles, and Togo, as well as two methodological issues: treatment of export credit agencies' guarantees that have not yet been triggered, and outreach to non-Paris Club creditors. End Summary.

Angola

¶4. (SBU) The Club again discussed the Angolan parliamentarians' proposal to swap the GOA's scheduled January 2010 late interest payment for projects in Angola. Despite discussions with a parliamentary delegation, there remained confusion about whether the swap would be for infrastructure and social projects, or for economic investments that would yield a return. The delegation had characterized the swap as a "win-win" proposition and had emphasized that they could and would make the $400 million payment if creditors did not agree to the proposed swap.

¶5. (SBU) Most creditors were not inclined to agree to the proposal; they expect payment. Only Norway expressed openness to the proposal but, because it was a very small creditor, would participate only if others handled negotiations, management, and monitoring of the deal. The Secretariat asked creditors to submit their official position on the swap proposal and would then draft a response letter for

discussion in September.

¶6. (SBU) The U.S. delegation met privately with the Angolan parliamentarians, who were accompanied by a representative of the central bank and by a banker from Portugal. The Angolan delegation explained its proposal. Not a party to the deal under which the January payment is due, the U.S. told the Angolans that the involved creditors would determine whether to support the proposal.

¶7. (SBU) The IMF reported that despite "commendable" progress in recent years, Angola had been impacted by the falls in oil and diamond prices, and by OPEC-driven production cuts. After several years of double-digit growth, GDP was expected to fall 1.5 percent in 2009, with corresponding deterioration in the country's financial and fiscal positions. Reserves had fallen by one-third in the first

half of 2009, to $11.8 billion. Angola was tightening monetary and fiscal policies to address the situation, with a May supplementary budget cutting spending by 17 percent, based on a predicted $37/bbl oil price. Still, this would leave a deficit of 8 percent of GDP, by GOA estimates. Angola had made significant progress in reducing its debt burden from 45 percent of GDP at end-2004 to 16 percent at end-2008; it could rise again to 25 percent by end-2009. The country was rated at "moderate" risk of debt distress. There was no interest in a Fund program, although the GOA was receptive to recommendations, sought closer dialogue with the Fund, and requested additional technical assistance.

Argentina/Brazil

¶8. (SBU) As in June, the major subject for discussion was Brazil's $700 million loan to state-owned Aerolineas Argentinas (and/or its subsidiary, Austral) for the purchase of Embraer aircraft. The Brazilian representative again failed to provide any meaningful responses, but did say that the agreement had not yet been signed. The terms and conditions were under discussion, and Embraer was to sign the contract soon. The information will then be delivered at the next meeting of the Participants of the Aircraft Sector Understanding (ASU) at the Organization for Economic Cooperation and Development (OECD). The delegate claimed not to know whether the loan involved GOB or GOA guarantees, or the general structure of the financing, as this was a deal between Embraer and Aerolineas Argentinas.

¶9. (SBU) When the Brazilian representative was not present, the U.S. stated that Brazil should not be allowed to delay, and proposed that the Club prepare a letter to the GOB to convey disappointment about the loan, which could undermine the Club's efforts to resume normal relations with Argentina. Other members agreed, and another creditor suggested inclusion of Brazil's failure to conclude a bilateral agreement with Iraq.

¶10. (SBU) The IMF reported that Argentina's bond prices had risen after the GOA's loss of majorities in both houses in the June 28 election, apparently on hopes that the congress would restrain the administration. End-May reserves remained robust, at $46 billion. The Fund noted press reports that Brazil and China had extended swap lines to Argentina of $1.8 billion and $10 billion, respectively. There had been no movement in relations with the Fund (no date for Article IV discussions), though the Bank reported on its new country strategy and on two recent loans for safety nets, valued at $840 million and $450 million.

Bahrain

¶11. (SBU) The Netherlands reported arrears since late 2008. The loans in question were to two separate ministries, one of which had cleared its arrears in early July. Nevertheless, the total had reached 6 million Euros. The Secretariat said Bahrain owed the Club about $84 million, two thirds of which was owed to the USG; however, Bahrain was current to the U.S. The Secretariat noted that after creditors provided a status of payments, it would draft a letter to the Bahraini authorities.

¶12. (SBU) The IMF reported that the macroeconomic situation was

"robust," reflecting GOB efforts to diversify the economy, especially the financial sector. Banking assets had soared, exceeding 1,000 percent of GDP at end-2008. Some banks had

experienced losses on assets in the West. There had been drops in deposits and financing, but the central bank had responded forcefully. In the Fund's view, the sector was weathering the crisis well. The central bank had developed a crisis response manual to monitor interbank activity, freeze new licenses, and encourage mergers; but complementary actions were required.

¶13. (SBU) Real GDP had grown 8 percent in 2007 and 6 percent in 2008, but growth was expected to fall to 2.5 percent in 2009. The current account and fiscal deficit had worsened, and reserves had fallen from 7.5 months of coverage of non-oil imports to 5.5 months. The IMF noted fiscal policy was neutral; spending increases could be appropriate. Some capital expenditures had been delayed but public-private partnerships were being explored to avoid increasing public debt.

Central African Republic

¶14. (SBU) The CAR reached completion point at the end of June, after Argentina had provided assurances that moved participation above the required 80 percent threshold. The Club agreed to negotiate

completion point treatment in September. There would be a data call later in July. A fifth review/Article IV IMF mission is scheduled for the end of September.

Democratic Republic of Congo

¶15. (SBU) Discussion again focused on China's proposed mining and infrastructure deal with the DRC, the only significant remaining obstacle to a PRGF program and progress toward HIPC debt relief. The IMF reported that China Railways had sent a letter to DRC authorities, on behalf of the joint venture, agreeing that there was no need for a sovereign guarantee for the mining portion of the project, but arguing that it needed to keep the sovereign guarantee on the remaining $3 billion infrastructure portion. The first annual review of the project was rescheduled for July 10-16 in Beijing, at which time the partners were expected to agree to remove the guarantee on the mining portion, as well as drop the second infrastructure phase valued at $3 billion.

¶16. (SBU) These moves would bring the package much closer to meeting the IMF's concerns about debt sustainability, although concessionality had not been addressed satisfactorily. A new Debt Sustainability Analysis (DSA) was being prepared, along with a report on the DRC's progress towards satisfying its completion point

triggers. Nevertheless, the IMF reported that "things could move relatively fast," and that the Fund could request financing assurances for the PRGF program in September, or sooner. The Bank reported that if a PRGF program were approved, management would propose lifting the ceiling on interim relief from 30 percent to 50 percent, as had been done for other countries. Completion of the feasibility study for the mining project, repeatedly delayed since late 2008, is now set for September. Several creditors sought confirmation of all the elements, including concessionality, the DSA, and information about litigating creditors, before addressing financing assurances.

Haiti

¶17. (SBU) In swift and cordial discussions, the Club and Haiti's delegation agreed on the terms of the country's completion point treatment. Because of Haiti's relatively low debt burden for a HIPC and a modest 14.2 percent common reduction factor, the Agreed Minute provided for forgiveness of a total of $62.7 million, but creditors

all agreed to more generous terms for Haiti, voluntarily going beyond the agreement to provide full forgiveness of all claims on Haiti worth an additional $152 million. This commitment was reflected in the Paris Club's press release, under the heading "Paris Club creditors cancel 100 percent of Haiti's debt."

Jamaica

¶18. (SBU) The Fund and Bank provided a briefing on the deteriorating situation in Jamaica, which faces challenging short- and long-term prospects. Jamaica faces macroeconomic imbalances, chronic low growth - with a 4 percent GDP decline expected in FY09-10 due to falls in tourism, remittances and bauxite prices - and high public debt levels. Between mid-September 2008 and February 2009, balance of payments pressures had brought about a 22 percent depreciation, while reserves had fallen by a third, to $1.6 billion, four months of import cover.

¶19. (SBU) Despite the recession and falling inflation, authorities had to tighten monetary policy considerably, raising the policy rate to 21.5 percent. They had also been forced to tighten fiscal policy in order to bolster confidence, with measures in the 2009-10 budget worth 2 percent of GDP, including a freeze of civil service wages and a fuel tax. The target was a deficit of 6.6 percent of GDP. The current account deficit had narrowed to 14 percent of GDP, but the country still faced a $600 million financing gap in FY 2009-10 and needed to reduce its debt overhang. Authorities have no room for a counter-cyclical fiscal response and were interested in a Stand-By Arrangement (SBA). Negotiations had begun during a June

Article IV mission and were continuing in Washington. Priorities for reform included improving public expenditure management, tax efficiency, and civil service reform.

¶20. (SBU) Jamaica's exposure to the Club was high, $481.5 million according to the recent global data call, but the Fund and authorities had not yet discussed whether the country would request Paris Club treatment. Jamaica's external debt had reached 124 percent of GDP with interest payments equaling 14 percent of GDP. The SBA's focus would be fiscal sustainability, and it was not clear whether this required debt restructuring.

Kazakhstan

¶21. (SBU) Discussion again focused on creditors' exposure to failed banks and the Club's proposed response. In June the Club had agreed to send a letter to authorities, but creditors had disagreed on what it should contain. The Secretariat's initial draft quoted the assertion in the recent joint letter from Export Credit Agencies (ECAs) that their claims should be excluded from restructuring and suggested that treatment of ECA claims could be a problem in any future Club restructuring. The U.S. delegation had privately told the Secretariat that this language was troubling. The Secretariat then circulated a new draft that expressed the Club's concern about

the situation and asked that the Club be kept informed about developments. Creditors agreed to the revised text with slight changes, though Germany and Italy voiced their preference for the more assertive version. Belgium noted that more ECAs appeared to be involved, perhaps as many as sixteen. The Club agreed to launch an accelerated data call, which would include bank-by-bank data.

Mali

¶22. (SBU) The Netherlands reported that Mali, a post-completion point HIPC, was in arrears. Arrears in March 2008 had been cleared, but had begun to accumulate again in mid-2008, reaching 500,000 Euros. France had also reported arrears in March 2008, but Mali was now current on payments. The IMF expressed concern regarding the arrears in view of its non-toleration policy, and asked whether the Netherlands considered the arrears to be technical; otherwise, a waiver would have been required. The Netherlands agreed to deem them technical arrears for now.

¶23. (SBU) The IMF reported that Mali had entered into a program in 2008, because of the crisis in food and fuel prices. The program was designed to strengthen public finances and introduce structural reforms, and its second review had been completed on July 6. Mali had made progress - the tax revenues/GDP ratio had risen from 9

percent in 2005 to 14 percent in 2007, fiscal balances were close to the zero target, and there had been progress on privatization. Nevertheless, poverty rates remained high, and progress towards the Millennium Development Goals (MDGs) was slow. The impact of the crisis had been limited, due to high gold prices, little bank exposure, and unexpectedly robust remittances, all bolstered by receding food and fuel prices. While the Bank opined that the country was very vulnerable to shocks, it was at a "low risk" of debt distress.

Seychelles

¶24. (SBU) The second review of Seychelles' program was completed on June 30, and creditors agreed that the first tranche of Seychelles' Evian Terms debt reduction could enter into force once the Secretariat had confirmed that South Africa had received its share of the $1 million goodwill payment. All Club creditors to the Seychelles had received payments.

¶25. (SBU) The IMF reported that there had been good policy implementation and that macroeconomic stabilization had reduced risks, so the Board approved a switch to a semi-annual review schedule. The next review would be based on end-September data and accompanied by a request for a 3-year loan under an Extended Fund

Facility (EFF) program. Although GDP was expected to fall 11 percent in 2009, the Fund's view was that a virtuous cycle was in place with a primary surplus well above program targets, inflation having declined sharply, and the real exchange rate having appreciated. Financing gaps remained for 2009 and 2010 however, due to the global recession and effects of piracy. African Development Bank (AfDB) and European Union (EU) support would fill some of the gaps.

Togo

¶26. (SBU) The Club agreed to enter into force the second phase of Togo's HIPC treatment, based on IMF completion of the second PRGF program review in April. The PRGF program, approved in April 2008, was augmented in September to respond to food and fuel prices and flooding; Togo reached HIPC decision point in November.

¶27. (SBU) The IMF reported "disciplined" implementation of the program despite multiple shocks. GDP was expected to grow 1.7 percent in 2009, with inflation falling below 3 percent. Exports and remittances had fallen, however, offsetting increases in food production and domestic investment. Revenue collections were on track, and spending was "disciplined." Most structural reforms were on or ahead of schedule, with only one minor delay (audit of

the state phosphate company) because of administrative capacity. Progress on completion point triggers was also good, with completion point possible during the second half of 2010. Nevertheless, capacity was weak and presidential elections in the first quarter posed risks.

Methodological Issues:
Inclusion in Data Calls and
Agreements of Un-triggered Guarantees

¶28. (SBU) The Secretariat released a paper on ECA guarantees that have not been triggered. The Club's survey on existing creditor practices found a wide variation on whether creditors include such credits in data calls, and if those credits are treated. The paper noted some arguments for including the credits - this seemed to be within the letter of Agreed Minutes, legal issues could probably be mitigated, and since Club treatments were designed to restore sustainability, all debts should be considered in order to ensure comparable treatment. On the other hand, the paper noted that the Agreed Minute definitions were not taken literally to apply to private creditors, that some creditors (especially the U.S. and Russia) would face legal obstacles in treating them, and that treating them would impose additional costs on creditors.

¶29. (SBU) The paper suggested three options - (1) continuation of the current ad hoc approach; (2) inclusion of the guarantees in all data calls and bilaterals; and (3) exclusion of the claims from all data calls and bilateral agreements. (A fourth possibility could be inclusion in data calls, but not necessarily in bilateral agreements.)

¶30. (SBU) There was a lengthy, although inconclusive, discussion of the issue, including several recent precedents in which the Club agreed to exclude such debts in order to avoid causing economic disruption. This included a tanker mortgage in the recent Seychelles agreement, and port loans to Grenada and Djibouti. The Secretariat suggested further discussion, perhaps by a working group on the margins of the September meeting.

Outreach

¶31. (SBU) The Secretariat updated creditors on outreach efforts, reporting in particular Israel's interest in joining the Club. (At the June outreach meeting with the private sector and other creditors, an Israeli MOF official had conveyed this interest to the U.S. delegation.) Club members were generally amenable to the approach, and the Club will proceed according to its outreach policy - first, requesting detailed data from Israel on its loan portfolio,

and then inviting Israel to observe meetings more extensively. The Secretariat requested that creditors check views in capitals to determine their positions on a) closer association with the Club and b) full membership. Israel may soon be contacting the Secretariat more officially.

¶32. (SBU) Among other outreach countries, Malaysia had reacted positively to the Secretariat's approaches. (Malaysia had asked to participate in the negotiations with Seychelles, but had been unable to make appropriate arrangements in time.) China had requested information, but had not followed up. The UAE had indicated that it was willing to share information and "in principle" to join negotiations, though it had not accepted the Club's invitation to the June meeting. India had provided "little feedback."

¶33. (U) For additional information on any of the countries or issues mentioned above, please contact EEB/IFD/OMA David Freudenwald at freudenwalddj@state.gov or Nicholle Manz at manznm@state.gov.

PEKELA